COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF JACKSON COUNTY RURAL ELECTRIC COOPERATIVE CORPORATION FOR AN AMENDMENT TO PRIOR ORDERS OF THE COMMISSION AUTHORIZING ISSUANCE OF EVIDENCE OF INDEBTEDNESS	)	CASE NO. 92-341

O R D E R

On August 12, 1992, Jackson County Rural Electric Cooperative Corporation ("Jackson County") filed a request that the Commission amend its prior Order entered in Case No. 8164,[1] to authorize the conversion from a fixed to a variable interest rate for National Rural Utilities Cooperative Finance Corporation ("CFC") Loan No. 9018. The term of this 35-year loan originally provided for a fixed interest rate for the first 7 years, after which, the rate would be renegotiated. Since the execution of this loan, interest rates have been substantially reduced and CFC has allowed borrowers to convert to a reduced variable interest rate. The current fixed interest rate for this loan is 8.75 percent. The variable rate applicable for this loan is 5.375 percent. On August 7, 1992, Jackson County's Board of Directors voted to convert to the variable rate.

---

[1] Case No. 8164, The Application of the Jackson County Rural Electric Cooperative Corporation for Authority to Borrow From the United States Government $4,011,000.00 and $1,809,000.00 From the National Rural Utilities Cooperative Finance Corporation (CFC) and to Execute Its Mortgage Note or a Series of Mortgage Notes to Secure the Same, Order dated April 14, 1981.

When converting from the fixed rate program to the variable rate program, CFC requires the payment of a conversion fee. The conversion fee for the loan is based on the difference in the interest rate on the note and CFC's long-term interest rate at the time the borrower elects to convert to the variable rate. The difference is applied to the outstanding loan balance at the start of the borrower's next first full quarterly billing cycle for the time remaining until a repricing option would have been allowed. A one-time, up-front fee of 25 basis points on the outstanding balance at the time of conversion is added to the conversion fee. The conversion fee could be paid either in quarterly payments or as a discounted up-front payment. The total conversion fee would be $57,094 if paid quarterly and $52,286 if paid up-front.

Jackson County provided an Internal Rate of Return ("IRR") analysis for the loan it proposed to convert. Under the IRR approach, the goal of the borrower would be to utilize the interest rate program which produces the lowest IRR. For each loan, Jackson County determined an IRR value for the following three different scenarios:

1. The current variable rate remained constant for the remainder of the pricing cycle ("Scenario I").

2. The current variable rate would begin increasing by .25 percent each quarter, beginning with the third quarter after conversion, for the remainder of the pricing cycle ("Scenario II").

3. The third scenario involved determining the variable interest rates which, when applied beginning with the third quarter

after conversion, would result in an IRR value approximately equal to the IRR value resulting from the current fixed interest rate. Jackson County considered this the break-even scenario.

Each scenario was run twice showing the impact on the IRR value of each payment option chosen for the conversion fee.

The analysis indicated that, under either Scenario I or II, the resulting IRRs for the variable interest rate were lower than the IRR for the fixed interest rate. The scenario results also indicate it is beneficial to Jackson County to pay the conversion fees up-front rather than quarterly. Scenario I resulted in a net cumulative savings of $55,456 when the conversion fees were paid up-front and $50,649 when the conversion fees were paid quarterly. Scenario II resulted in a net cumulative savings of $18,608 when the conversion fees were paid up-front and $13,800 when the conversion fees were paid quarterly. Under the assumptions incorporated in Scenario II, the increasing variable interest rate on individual loans resulted in significantly lower savings when the conversion fee was paid quarterly.

In its request, Jackson County indicated that it would pay the conversion fees over several periods due to its current cash position. Jackson County stated that it viewed the assumptions in Scenario II to be a "worst case" scenario. While stating that it did not see variable interest rates increasing or decreasing dramatically in the next few months, Jackson County would continue to monitor interest rates and whenever indicators showed it to be advantageous, it would lock into a fixed rate. Based upon Jackson

County's analyses and the conditions presented in this case, the conversions of the loan should result in interest savings on an IRR basis and the loan should be converted as requested.

IT IS THEREFORE ORDERED that:

1. The Commission's Order entered in Case No. 8164 be and is hereby modified to authorize the conversion from a fixed to a variable rate program for CFC Loan No. 9018.

2. Jackson County shall notify the Commission of the closing date of the conversions and shall file, within 30 days of the conversions, all documents pertaining thereto.

3. Jackson County shall file, along with its monthly financial report to the Commission, the current interest rate on its variable rate loans outstanding.

4. All provisions of the Commission's Order dated April 14, 1981, which are entered in Case No. 8164 shall remain in full force and effect.

Done at Frankfort, Kentucky, this 31st day of August, 1992.

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Executive Director